

Robo-advice in ten points – asset management on the cusp of dramatic change



The asset management industry is currently in a state of flux, and the manner in which individuals and institutions interact with their wealth managers is on the cusp of dramatic change. Digitisation and increased use of technology should mean that we are at the point of a low-cost revolution. This is likely to impact job security in financial services and will radically re-shape the industry with dramatically lower employment likely across all major centres.

Hiring managers are expecting numbers to fall, with few exceptions. From advice through to investment and distribution and at both firms large and small. However, on a social level the importance of robo-advice is how these changes will alter how society consumes, saves and invests in the future, and how much we pay for this (much less, hopefully!)

Many wealth managers are currently buoyed up by record profits generated through five years of ever-increasing asset prices caused by loose monetary policy and ultra-low interest rates. Asset managers still have share prices and enterprise values implying further good times ahead and no exit from the land of plenty. But these numbers hide the upcoming storm. A different story of new market entrants using automation to slash costs while at the same time leveraging technology to improve risk management and compliance has been emerging for some time. The new digital era will make the future more of a challenge for older financial institutions.

Currently the asset management process is unwieldy, with multiple steps between end-users and financial professionals. An investor will typically deal with several separate firms paying fees at every step of the investment process. This convoluted and complicated approach is time-consuming as well as costly. There is hope that a growing number of financial technology firms, or fintechs, can change this.

This evolution has been supported by regulators worldwide, but particularly by the Financial Conduct Authority (FCA) in London. The FCA is hopeful that increased use of technology could finally enable the provision of advice to mass-market segments, including segments that have previously been unreachable by financial advice. They estimate this could be as many as 16 million people in the UK alone, and have set up a dedicated Robo-Advice Unit to support digital or tech-led asset managers bring products to market. Here we outline the key points of Robo-Advice, which is being hailed as the *'future of asset management.'*

Robo-advice in ten points:

- **Robo-advice is online:** Rather than an expensive to maintain branch network, robo-advisors save money and can increase customer convenience by allowing a digital experience.
- **The key is probably cost:** Regulatory change and ease of use will create momentum and growth. Robo-advisors can be 60-70 per cent cheaper than traditional solutions and can provide savings of 1 percentage point per year of assets. Over a lifetime of investing, this would make £100,000s of difference to millions of investors in the UK alone.
- **Growth is strong:** Whilst still only a fraction of the market, the assets under management of major players are growing between 50 and 100 per cent per year, and new entrants and concepts are developing all the time. There are currently over 100 robo-advisors in Europe with most based in either Germany or the UK.
- **There is a long way to go:** Nutmeg, the UKs' largest robo, has \$1bn in assets, but Legal and General, the UK's largest traditional asset manager, has over \$1 trillion – a thousand times larger. Data in the US is similar, with BlackRock having \$6 trillion under management and Betterment, the largest US robo, having a fraction of this.
- **On-boarding is a noted differentiator, but also a concern:** On-boarding, the process of bringing new customers to the platform, is conveniently and efficiently done online, but there are regulatory worries concerning know-your-client rules and suitability. The faster process and fact finding may not always be up to date with regulations or as rigorous as it should be.
- **Millennials are less important than predicted:** Most of the original players in this nascent market targeted millennials. But older, wealthier and still tech-savvy baby boomers have become core clients.
- **Robo-advisors mainly use ETFs:** To create diversified and low-cost investment pools, robos have mainly been using exchange traded funds (ETFs) which are generally passive, low-cost, liquid investments.
- **Future robo-advisors will be more sophisticated:** A portfolio solely consisting of ETFs can be generated quickly and easily but doesn't allow more tailored risk matching or factor exposure.
- **Robo-advice aids financial inclusion:** Large sections of society, typically the financially less literate, have been excluded from the best investment solutions by the high initial costs of financial advice. Both the regulator and the industry are hoping that robo-advice will improve participation and access to the investment process.
- **Robo-advisors typically use Modern Portfolio Theory:** Robo-advisors typically use mean-variance optimisation for asset selection, but future solutions are likely to use Liability Driven Investment (LDI) frameworks for portfolio construction.

Summary

With strong growth and regulatory support, robo-advisors are here to stay. The cost-advantage of these fintechs is likely to create a great deal of social utility over the next decades. By stimulating interest in saving for the future and widening access to investment with an easier customer journey, financial security, stability and knowledge can all increase. But despite all the attention from press, venture capitalists, banks and regulators globally, digital wealth managers currently represent less than 0.1 per cent of the savings market so the journey is only at the beginning.



Notes:

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